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IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

No. 81-120

CITIBANK, N.A., and UNITED BANK
OF DENVER, NATIONAL ASSOCIATION,
as Indenture Trustees,
Petitioners,

v.

PHOENIX RESOURCES COMPANY,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

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OPINION BELOW

The opinion of the United States Court of Appeals for the Tenth Circuit, not yet reported, is printed in petitioner's Appendix A.

JURISDICTION

The jurisdictional requisites are adequately set forth in the Petition.

QUESTION PRESENTED

Whether the Tenth Circuit was correct in concluding that a bankruptcy Rule which would permit compensation to a fiduciary who had voluntarily sold his own claims during a reorganization proceeding went beyond the Enabling Act in effecting a substantive change from Section 249 of the former Bankruptcy Act, which absolutely barred compensation to such fiduciaries?

STATEMENT OF THE CASE

Petitioners Citibank and United Bank were trustees for holders of foreign and domestic debentures which had been issued by King Resources Company ("KRC") in the Fall of 1968. Both banks continued to act as trustees during the KRC reorganization which commenced in 1971.

In addition to their fiduciary role, the banks also pursued their own claims during the reorganization; each bank had loaned about $3 million to KRC. During the proceedings, the claims of both banks were allowed.

In August of 1977, after a Plan of Reorganization had been approved by the bankruptcy court, Citibank and United Bank sold their individual claims to Texas International Company. United Bank's claim was sold for $3,259,203.59. Citibank sold its claim for $3,328,158.12.

A year later, in August of 1978, the banks applied for compensation, along with the other participants in the reorganization, for the services which they had performed in their fiduciary capacity as indenture trustees. The banks' applications were objected to both by the Securities Exchange Commission and by Phoenix Resources Company, the reorganized debtor, on the ground that Section 249 of the Bankruptcy Act prohibited the award of compensation to fiduciaries who had voluntarily sold their individual claims after reorganization proceedings had commenced. In response to these objections, and for the first time, Citibank and United Bank asked the reorganization court to approve, retroactively, the sale of their claims. Citing Bankruptcy Rule 10-215(c) (4), and again over the objection of the Securities Exchange Commission and Phoenix, the court retroactively approved the sales, and awarded total compensation to United Bank in the amount of $343,756.78 and to Citibank in the amount of $556,016.30.

On March 13, 1981, the United States Court of Appeals for the Tenth Circuit held that in providing for a right of compensation to fiduciaries who had voluntarily transferred their own claims, Bankruptcy Rule 10-215(c) (4) effected an abridgment or modification of substantive rights of the reorganization estate and an enlargement of the rights of fiduciaries, and thus exceeded the authority granted by the enabling legislation.

On April 21, 1981, the Tenth Circuit denied Citibank's and United Bank's petition for rehearing and suggestion for rehearing en banc.

ARGUMENT

I. NO NOVEL TEST FOR DISTINGUISHING BETWEEN SUBSTANCE AND PROCEDURE IS EITHER IMPLEMENTED OR PROPOSED BY THE TENTH CIRCUIT, WHOSE ANALYSIS IS CAREFULLY FOUNDED UPON STANDARDS ESTABLISHED BY THIS COURT IN *HANNA v. PLUMER* AND OTHER CASES

The focus of the banks' Petition is a contention that the United States Court of Appeals for the Tenth Circuit "invented" a test for distinguishing between substance and procedure. The banks maintain that the Tenth Circuit disregarded the standards previously articulated by this Court, and they warn that "the entire fabric of the rules is threatened" by what they label a "misguided opinion." (Petition, pp. 8-9). However, when one actually examines the opinion itself, rather than the banks' strident recrafting of it, it is apparent that the Tenth Circuit neither applies nor suggests any new test or standard, but instead implements the language and the principles of this Court's analysis in *Hanna v. Plumer*, 380 U.S. 460 (1965), and carefully anchors its approach to the specific purpose and statutory context of bankruptcy compensation.

In its opinion, the Court of Appeals first emphasizes the conflict between the statute and the rule: Section 249 of the former Bankruptcy Act automatically and absolutely bars compensation to fiduciaries who voluntarily transfer their own claims during a bankruptcy proceeding; Rule 10-215(c)(4), on the other hand, would allow compensation to such fiduciaries upon court approval. The Court of Appeals then explains why in the bankruptcy court the awarding of compensation to the professional participants is not merely a procedural incident of other rights, but is itself a matter of substantive rights and duties; the Court of Appeals concludes:

> "The expectation of compensation and the 'right' to compensation of those who perform valuable services based on the provisions of statute is for this group [professional participants in the bankruptcy proceedings] and others a substantive matter. It is also substantive in other aspects of bankruptcy. Compensation is a basic, essential, and independent part of the system."

(Opinion of the Tenth Circuit, reprinted in Petition, p. 6a).

It is in this connection that the Court of Appeals observes that the importance of compensation in the bankruptcy setting has led to a separate treatment and use of fees, developments which have in turn affected the result that those who "in good faith provide valuable services have a right to rely on the provisions for compensation." The Court of Appeals then holds:

> "The removal by the Rule of an outright prohibition against receiving compensation was a change in a substantive matter, *was an abridgement or modification of substantive rights of the estate and an enlargement of the rights of fiduciaries.* The Rule must be regarded as going beyond the enabling legislation, and Section 249 must be applied." [Emphasis added].

(Opinion, Petition, p. 7a).

Citing this Court's decisions in *Mississippi Pub. Corp. v. Murphee*, 326 U.S. 438 (1946), and *Hanna v. Plumer*, 380 U.S. 460 (1965), the Tenth Circuit stresses that, "The 'rights' in the case are changed and the application of these rights is changed." (Opinion, Petition, p. 8a). The Court of Appeals thus properly focuses upon the fact that the bankruptcy Rule effected a modification or abridgment of the substantive rights of the estate and an enlargement of the substantive rights of fiduciaries, scarcely a unique or novel application of the substance-procedure distinction, but certainly the correct one. Ignoring this, the banks maintain that the Court of Appeals "concluded that the importance of Rule 10-215(c) (4), when combined with its character as a 'separate element'

made it 'substantive' and therefore void . . . The articulated test, however, has never before been expressed by any court." (Petition, p. 6). Of course, this allegedly "articulated test" nowhere appears in the opinion of the Court of Appeals. In the end, it is the banks, not the Court of Appeals, who have invented a new standard. The Petition can hardly be fortified by this invention.

II. THE TENTH CIRCUIT CORRECTLY APPLIES THE SUBSTANCE-PROCEDURE DISTINCTION; AS THE COURT OF APPEALS RECOGNIZES, THE BANKRUPTCY RULE WENT BEYOND THE ENABLING ACT BY AFFORDING RIGHTS OF COMPENSATION TO A CLASS FOR WHICH THE FORMER BANKRUPTCY ACT EXPRESSLY BARRED COMPENSATION

Section 249 of the former Bankruptcy Act provided, in part, that:

> "No compensation or reimbursement shall be allowed to any person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold . . . claims or stock . . ."

Citibank and United Bank did not dispute that they were acting in the KRC proceedings in a fiduciary capacity. Nor did they dispute that after assuming to act in that capacity they sold their own claims against the debtor. Rather, in seeking compensation the banks sought to rely upon Bankruptcy Rule 10-215(c) (4) which, departing from the statute in this respect, prohibits compensation only to fiduciaries who purchase or sell claims against the debtor without court approval. Since under the Enabling Act, 28 U.S.C. §2075, the Bankruptcy Rules may not "abridge, enlarge or modify any substantive rights," the question squarely presented was whether the effect of Rule 10-215(c) (4) was in fact to abridge or modify the substantive rights of compensation prescribed by Section 249.

As the Tenth Circuit recognized, in every traditional sense the bankruptcy Rule effected a substantive change from the

statute. It afforded a right of compensation to a specific class (fiduciaries who had voluntarily sold their own claims during the pendency of the proceedings) for which the statute had expressly barred compensation. The Rule did not simply regulate a process for enforcing rights or duties recognized by substantive law; rather, it provided a previously non-existent, indeed a previously prohibited right of compensation to a fiduciary who voluntarily transacted in his own claims against the estate.

In this connection, it is difficult to know what to make of the banks' contention in their Petition that since both the bankruptcy Rule and Section 249 permitted court approval of transfers (i.e. involuntary transfers) of claims "no new element was added or subtracted by the Rule." (Petition, p. 11). To say that the Rule added "no new element" is true only in the not particularly meaningful sense that both the Rule and the statute have some relation to court approval; i.e. under Section 249 no court approval could validate a prohibited voluntary transfer of claims by a fiduciary, whereas under the Rule a right of compensation was afforded to such fiduciaries with court approval. But that of course is the essence of a substantive provision, that it creates, enlarges or modifies substantive rights. In *Wolf v. Weinstein*, 372 U.S. 633 (1963), this Court rejected an argument which would have read an exception into Section 249 for trading by officers of the company. Writing for the Court, Mr. Justice Brennan said:

> "The application of Section 249 turns not upon the manner in which, or the time at which payment is made, but rather upon the nature of the services and responsibilities which are being compensated . . . Section 249 does no more than declare that one who invests in a debtor's stock during a reorganization ceases to be disinterested for purposes of compensation and allowances."
>
> 372 U.S. at 648, 653 n.20.

The banks' semantic argument in their Petition that the Rule adds "no new element" to this statute only underscores the correctness of the Tenth Circuit's conclusion that Rule 10-215 (c) (4) does substantively modify the statute, and thus also exceeds the authority afforded by the enabling legislation.

III. THE OPINION OF THE TENTH CIRCUIT DOES NOT ELIMINATE JUDICIAL CONTROL OF FIDUCIARY COMPENSATION IN BANKRUPTCY PROCEEDINGS; RATHER, IT REAFFIRMS SPECIFIC STATUTORY LIMITS ON RIGHTS OF COMPENSATION UNDER THE FORMER BANKRUPTCY ACT

The banks maintain, without analysis, that the opinion of the Court of Appeals somehow "eliminated judicial control of fiduciary compensation in bankruptcy proceedings." (Petition, p. 9). In the first place, this case can have no effect on compensation to fiduciaries in proceedings commenced after October 1, 1979, when the Bankruptcy Reform Act of 1978, Pub. L. 95-598, 92 Stat. 2549 (1978), repealed the Bankruptcy Act. The Reform Act provisions related to compensation and reimbursement contain no restrictions similar to Section 249, so that the matter of compensation for fiduciaries is left to the discretion of the bankruptcy judges. With respect to proceedings commenced before October 1, 1979, judicial control is "eliminated" only in the sense that the Court of Appeals has confirmed that the former statute meant what it said and could not be substantively modified by a bankruptcy rule, i.e. fiduciaries who choose voluntarily to transfer their own claims are not entitled to compensation.

That the banks' Petition presents no substantial or compelling basis for review is highlighted, finally, by what the banks would apparently offer as a substance-procedure standard for this case:

> "The double elements of simple fairness and the importance of representation of every interest in the reorganization process make compensation procedural and a matter which 'relates to the administration of legal proceedings' rather than to a substantive bankruptcy matter." (Petition, p.10)

Thus importing into their own argument the factor of "importance" which they purport to discern with alarm in the Tenth Circuit's opinion, and adding to that the element of "simple fairness," the banks would present to this Court a far less cogent and far less traditional approach than the one correctly implemented by the Court of Appeals. Nothing in the banks' Petition suggests that a different analysis should have been made by the Tenth Circuit or that a review of the opinion below would or should yield a different result.

CONCLUSION

For these reasons, it is respectfully submitted that the Petition should be denied.

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